

**REBUTTAL TESTIMONY OF**  
**JAMES I. WARREN**  
**ON BEHALF OF**  
**DOMINION ENERGY, INC.**  
**DOCKET NO. 2017-370-E**

**INTRODUCTION**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is James I. Warren. My business address is 900 Sixteenth Street,  
N.W., Washington, D.C. 20006.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am a tax partner in the law firm of Miller & Chevalier Chartered  
("M&C").

**Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES AT M&C.**

A. I am engaged in the general practice of tax law. I specialize in the taxation  
of, and the tax issues relating to, regulated public utilities. Included in this area of  
specialization is the treatment of taxes in regulation.

**Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?**

A. I am submitting this testimony on behalf Dominion Energy, Inc.  
("Dominion Energy") in support of the Joint Petition filed by Dominion Energy  
and South Carolina Electric & Gas Company ("SCE&G").

1   **Q.   PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

2   A.           For more than 30 years, I have been involved in the provision of tax  
3           services almost exclusively to companies in various segments of the regulated  
4           utility industry. I joined M&C in February of 2012 from the law firm Winston &  
5           Strawn. Prior to that, I was a partner in the law firm of Thelen Reid Brown  
6           Raysman & Steiner LLP. I was affiliated with the international accounting firms  
7           of Deloitte LLP (October 2000 – September 2003), PricewaterhouseCoopers LLP  
8           (January 1998 – September 2000) and Coopers & Lybrand (March 1979 – June  
9           1991) and the law firm Reid & Priest LLP (July 1991 – December 1997). At each  
10          of these professional services firms, I provided tax services primarily to regulated  
11          electric, gas, telephone, and water industry clients. My practice has included tax  
12          planning for the acquisition or transfer of business assets, operational tax planning,  
13          and the representation of clients in tax controversies with the Internal Revenue  
14          Service (“IRS”) at the audit and appeals levels. I have often been involved in  
15          procuring private letter rulings or technical advice from the IRS National Office.  
16          On several occasions, I have represented one or more segments of the utility  
17          industry before the IRS and/or the Department of Treasury regarding certain tax  
18          positions adopted by the federal government.

19               I have testified before several Congressional committees and  
20          subcommittees and at Department of Treasury hearings regarding legislative and  
21          administrative tax issues of significance to the utility industry. I am a member of  
22          the New York, New Jersey and District of Columbia Bars. I am also a member of

1 the American, Federal and District of Columbia Bar Associations.

2 I am licensed as a Certified Public Accountant in New York and New  
3 Jersey.

4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

5 A. I earned a B.A. (Political Science) from Stanford University, a law degree  
6 (J.D.) from New York University School of Law, a Master of Laws (LL.M.) in  
7 Taxation from New York University School of Law and a Master of Science  
8 (M.S.) in Accounting from New York University Graduate School of Business  
9 Administration.

10 **Q. HAVE YOU TESTIFIED IN REGULATORY PROCEEDINGS?**

11 A. Yes. I have testified regarding tax, tax accounting, and regulatory tax  
12 matters before a number of regulatory bodies including the Federal Energy  
13 Regulatory Commission and the utility commissions of Arizona, Arkansas,  
14 California, the City of New Orleans, Connecticut, Delaware, the District of  
15 Columbia, Florida, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine,  
16 Maryland, Missouri, Nevada, New Jersey, New York, North Carolina, Ohio,  
17 Oklahoma, Pennsylvania, Tennessee, Texas, Vermont, Virginia, and West  
18 Virginia.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

20 A. The purpose of my testimony is to respond to certain aspects of the direct  
21 testimony of Lane Kollen filed on behalf of the Office of Regulatory Staff  
22 (“ORS”). I will focus on a description of the deferred income taxes included in the

Capital Cost Rider in the Customer Benefits Plan, and Mr. Kollen’s recommendation that only \$67.1 million of the deferred tax asset (“DTA”) relating to SCE&G’s tax net operating loss carryforward (“NOLC”) should be included in the rate base calculation. Kollen, page 37, lines 5-12. The inclusion of the entire NOLC-related DTA proposed by the Joint Petitioners under the Customer Benefits Plan is an integral part of a complete economic proposal which enables the transaction to move forward. It should not be segregated from the rest of the package. Mr. Kollen dis-integrates the proposal. His “cherry picking” diminishes the economic viability of the transaction. I will address the merits of Mr. Kollen’s proposal on a “stand-alone” basis – that is, assuming the Customer Benefits Plan was not a single, indivisible economic plan. I will also address his proposals to (1) amortize “unprotected” plant-related excess deferred income taxes over a five-year period (Kollen, page 57, lines 1-4) and (2) amortize the NOLC-related DTA over ten years (Kollen, page 40, lines 6-10).

#### **THE CUSTOMER BENEFITS PLAN**

**Q. PLEASE DISCUSS THE TREATMENT OF ACCUMULATED DEFERRED INCOME TAXES IN THE CAPITAL COST RIDER UNDER THE CUSTOMER BENEFITS PLAN.**

A. Any deferred tax liability (“DTL”) measured against the book basis of the NND Project shall reduce the cost to customers of SCE&G’s recovery of the NND Project. The entire balance of SCE&G’s NOLC-related DTA, approximately \$0.8 billion inclusive of the tax reform benefits (\$2.0 billion X 38.25%), will be

1 reflected as a rate base offset, dollar for dollar, to the DTL. Reductions in the  
2 NOLC-related DTA shall be subject to Dominion Energy's ability to use the  
3 NOLC to reduce its consolidated income tax liability in accordance with Internal  
4 Revenue Code Sections 172 and 382 and shall be computed on a consolidated and  
5 not a separate company basis. The NOLC-related DTA discussed further in my  
6 testimony below is estimated as of the end of 2018, and may be adjusted in the  
7 next annual filing as 2018 tax information becomes available or if the NND-  
8 related deductions are not sustained for tax purposes at any point.

9 Adjustments to the DTL and the DTA resulting from the Tax Cuts and Jobs  
10 Act will be returned to or recovered from SCE&G customers in the following  
11 manner:

- 12 • The regulatory liability resulting from excess deferred tax liabilities  
13 measured against the book basis of the NND Project will be returned to  
14 customers over the book recovery period of the NND investment (i.e., 20  
15 years);
- 16 • The regulatory asset resulting from excess deferred tax assets on any net  
17 operating loss carryforward will be recovered from customers in a manner  
18 that coincides with Dominion Energy's ability to use the net operating loss  
19 in filing its consolidated income tax returns and not on a separate company  
20 basis and will reduce rate base as the operating losses are utilized; and
- 21 • The amounts reflected above shall be adjusted if the deductions are not  
22 sustained for tax purposes at any point.

1                   **SCE&G'S 2017 NET OPERATING LOSS CARRYFORWARD**

2   **Q.    IS THERE AN ASPECT OF MR. KOLLEN'S APPROACH TO THIS ISSUE**  
3   **WITH WHICH YOU AGREE?**

4   A.           Yes, there is. Assuming the Customer Benefits Plan was not a single,  
5               indivisible economic plan, which it is, I agree with Mr. Kollen's basic premise that  
6               the NOLC-related DTA should be allocated between customers and shareholders.  
7               However, I strongly disagree that his allocation methodology even comes close to  
8               achieving the proper balance.

9   **Q.    WHAT IS A TAX NET OPERATING LOSS ("NOL")?**

10 A.           An NOL is created when, in any year, a taxpayer reports more deductions  
11               than it has taxable revenue. Prior to 2018, an NOL could, generally, be carried  
12               back two years or forward twenty years.<sup>1</sup> In the year to which it is carried, an  
13               NOL is treated like an additional deduction, reducing the taxable income  
14               otherwise produced in that year.

15 **Q.    WHAT ARE THE CONSEQUENCES OF CARRYING AN NOL**  
16 **FORWARD?**

17 A.           When an NOL must be carried forward, some quantity of the deductions  
18               claimed by the taxpayer in the year the NOL is produced will not offset taxable  
19               income and not reduce the taxpayer's tax liability – that is, until a subsequent year  
20               when the carryforward is used.

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<sup>1</sup> Note that NOLs created after 2017 cannot be carried back at all. Since the SCE&G NOL that is relevant to this proceeding was created in 2017, it was governed by the "old" rules.

1 **Q. DID SCE&G GENERATE A FEDERAL NOLC IN 2017?**

2 A. Yes, it did. As a result of the extremely large deductions attributable to its  
3 NND investment (the abandonment loss and its research and experimental  
4 (“R&E”) deduction), SCE&G’s 2017 tax deductions significantly exceeded its  
5 2017 taxable revenue.

6 **Q. WHAT DOES AN NOLC MEAN IN TERMS OF ACCUMULATED**  
7 **DEFERRED INCOME TAX (“ADIT”)?**

8 A. Deferred taxes represent a fund of available cost-free capital that is created  
9 by reducing a utility’s tax liability when tax deductions like accelerated  
10 depreciation are claimed. This fund is reflected in the utility’s ADIT balance,  
11 memorializing the fact that an amount of tax has been deferred but must be repaid  
12 at a later date. Until such repayment, the enterprise has the use of the funds on a  
13 cost-free basis. When a utility claims a tax deduction such as accelerated  
14 depreciation, it records a deferred tax liability (“DTL”) in its Account 281, 282  
15 and 283, as appropriate, regardless of whether or not it has an NOL. However, to  
16 the extent it does have an NOL (that cannot be carried back), the utility’s tax  
17 liability has not yet been reduced by some portion of those deductions. Thus, to  
18 that extent, no tax has been deferred and no cost-free capital produced. The tax  
19 effect of deductions that do not defer tax is reflected in the utility’s accounts  
20 (Account 190, 281, 282 or 283) as a DTA. In determining rate base, it is  
21 necessary to consider the DTA balance in conjunction with the DTL balance  
22 because the DTLs, taken alone, overstate the level of cost-free capital the utility

1 possesses. In effect, the ADIT DTL needs to be adjusted so that the correct level  
2 of cost-free capital can be reflected as a reduction in rate base.

3 **Q. IS MR. KOLLEN IN ACCORD WITH THIS VIEW?**

4 A. He appears to be in accord. His testimony supports the inclusion of the  
5 NOLC-related DTA in rate base – but only to the extent that it relates to the  
6 NOLC attributable to the portion of the tax deductions that relate to NND costs for  
7 which customers will be held responsible (“allowed” costs) and not for the portion  
8 for which shareholders will be held responsible (“disallowed” costs).

9 **Q. THEN, IN WHAT REGARD DO YOU DISAGREE WITH MR. KOLLEN?**

10 A. Mr. Kollen and I disagree over the proper methodology for allocating the  
11 NOLC between customers and shareholders.

12 **Q. WHAT WOULD BE THE PROPER WAY TO ALLOCATE THE NOLC?**

13 A. Under a dis-integrated approach, I use a “three-step” process. First, I  
14 quantify the amount of the 2017 NND-related deductions. I then determine how  
15 much of these tax deductions created an NOLC for the year. Finally, I allocate  
16 that amount of NOLC between customers and shareholders based on the relative  
17 proportions of the total investment in the NND property that each class will bear.

18 **Q. WHAT IS AN ABANDONMENT LOSS?**

19 A. Section 165 of the Internal Revenue Code permits a deduction for any loss  
20 sustained during the taxable year. The basis for determining the amount of the  
21 deduction for any loss is the taxpayer’s adjusted tax basis in the subject property.  
22 The tax basis of a physically abandoned asset represents such a sustained loss



1 within the meaning of section 165.

2 **Q. WHAT WAS SCE&G'S TAX BASIS IN THE NND PROPERTY WHICH IT**  
3 **ABANDONED IN 2017?**

4 A. Roughly, SCE&G's total investment in the NND property for tax purposes  
5 was \$5.4 billion. Through 2017, SCE&G deducted approximately \$1.7 billion of  
6 that amount as R&E costs. The amount so deducted did not get added to  
7 SCE&G's tax basis. Thus, SCE&G's tax basis in its NND property approximated  
8 \$3.7 billion.

9 **Q. DO PRIOR BOOK WRITE-OFFS IMPACT THE TAX BASIS**  
10 **COMPUTATION?**

11 A. No, they do not. The write-offs were for book purposes only. They  
12 produced no tax deductions. The NOLC is purely a tax number. Prior book write-  
13 offs are irrelevant to computing tax basis (though if accepted for rate making  
14 purposes, they can impact the amount of the total NND investment for which  
15 customers will ultimately be responsible).

16 **Q. IS \$3.7 BILLION THE APPROXIMATE AMOUNT OF THE NND**  
17 **ABANDONMENT LOSS CLAIMED BY SCE&G ON ITS 2017 TAX**  
18 **RETURN?**

19 A. Yes, it is – except that in reflecting the deduction on its tax return, SCE&G  
20 netted against this deduction the \$1.1 billion of Toshiba proceeds which it treated  
21 as a recovery of its NND costs. Thus, its 2017 abandonment loss as presented on  
22 its 2017 tax return was approximately \$2.6 billion.

1 **Q. WHAT ABOUT THE R&E COSTS SCE&G DEDUCTED IN 2017?**

2 A. These approximated \$350 million. Since these costs represented NND  
3 investment (the costs were included in the \$5.4 billion total NND investment), the  
4 deduction constitutes a 2017 deduction attributable to SCE&G's NND investment.

5 **Q. WHAT, THEN, IS THE TOTAL NND INVESTMENT THAT WAS**  
6 **DEDUCTED ON SCE&G'S 2017 TAX RETURN?**

7 A. It equals the sum of the abandonment and the R&E deductions –  
8 approximately \$2.95 billion.

9 **Q. IS THIS THE AMOUNT OF SCE&G'S NOLC FOR THAT YEAR?**

10 A. No, it is not. Before considering SCE&G NND-related deductions,  
11 SCE&G generated approximately \$300 million of taxable income in 2017. That  
12 amount of its NND-related deductions was used to offset this income. This  
13 reduced SCE&G's NOL for the year. Also, some portion of SCE&G's 2017 NOL  
14 can be carried back to prior years. This carryback has produced a tax refund and  
15 has, at the same time, reduced the amount of the NOL that can be carried forward.  
16 The approximate amount of the total SCANA carryback is \$760 million. Of this,  
17 \$300 million is attributable to SCE&G.

**Q. WHAT, THEN, IS THE APPROXIMATE AMOUNT OF SCE&G'S 2017 NOLC THAT IS ATTRIBUTABLE TO ITS NND INVESTMENT?**

A. The following table presents the computation:<sup>2</sup>

Total NND Investment (Tax)	\$5,400,000,000
Total R&E Deductions	(\$1,700,000,000)
Toshiba Proceeds	(\$1,100,000,000)
2017 Abandonment Loss	\$2,600,000,000
2017 R&E Deductions	\$350,000,000
2017 NND Deductions	\$2,950,000,000
2017 Taxable Income w/o NND Deductions	(\$300,000,000)
2017 NOL	\$2,650,000,000
NOL Carryback	(\$300,000,000)
<b>2017 NND-Related NOLC</b>	<b>\$2,350,000,000</b>

**Q. HOW WOULD YOU PROPOSE TO ALLOCATE THE NOLC BETWEEN CUSTOMERS AND SHAREHOLDERS UNDER A DIS-INTEGRATED APPROACH?**

A. I propose to use the same approach Mr. Kollen employs. That is, I propose to allocate to customers the proportion of the 2017 NOLC which is equal to the proportion of the total NND book investment for which they will be responsible.

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<sup>2</sup> Amounts have been rounded for simplicity.

1 **Q. DOES MR. KOLLEN PROVIDE THE RELEVANT FIGURES TO MAKE**  
2 **THE COMPUTATION?**

3 A. He does. On page 14, lines 12-14, of his testimony, he states that the actual  
4 total NND book investment is \$4,645.5 million and that customers will be  
5 responsible for \$2,771.6 million of the investment. Consequently, the proportion  
6 of the total investment for which customers will be responsible will approximate  
7 60% ( $\$2,771.6 / \$4,645.5$ ). Obviously, this division of financial responsibility  
8 represents an assumption on Mr. Kollen's part. If some other division of  
9 responsibility is ultimately ordered, the applicable percentage will change  
10 accordingly.

11 **Q. BASED ON THIS RATIO, HOW MUCH OF SCE&G'S 2017 NOLC**  
12 **WOULD BE PROPERLY ALLOCABLE TO CUSTOMERS?**

13 A. Based on Mr. Kollen's assumption that customers will be responsible for  
14 approximately 60% of the NND investment, the allocable NOLC amount  
15 approximates \$1.4 billion ( $\$2,350,000,000 \times 60\%$ ), which equates to an NOLC-  
16 related DTA of \$0.5 billion ( $\$1.4 \text{ billion} \times 38.25\%$ ).

17 **Q. HOW MUCH OF THE NOLC-RELATED DTA SHOULD, THEREFORE,**  
18 **BE INCLUDED IN RATE BASE?**

19 A. Based on this approach and on Mr. Kollen's assumption regarding the  
20 division of responsibility, the NOLC-related DTA in rate base ought to  
21 approximate \$0.5 billion. This is a far cry from the \$67.1 million proposed by Mr.  
22 Kollen.

1 **Q. IN YEARS AFTER 2017 WHEN SCE&G'S NOLC IS USED, WOULD THIS**  
2 **SAME METHOD BE USED TO ALLOCATE THE NOLC UTILIZATION?**

3 A. Yes, it would. Each dollar of NND-related NOLC utilization should be  
4 allocated between customers and shareholders based on the percentage of that  
5 NOLC that relates to each class – that is, the ratio of allowed NND costs to total  
6 NND costs. For example, assume that SCE&G's taxable income in 2018 is  
7 \$350,000,000. The NOLC would therefore be \$2,000,000,000 at the end of 2018  
8 of which \$1.2 billion, and the NOLC-related DTA of \$0.46 billion, would be  
9 allocable to customers under the dis-integrated approach.

10 **Q. IS THIS THE COMPANY'S PROPOSAL?**

11 A. No. The inclusion of the full DTA for the NOLC proposed by the Joint  
12 Petitioners under the Customer Benefits Plan is an integral part of a complete  
13 economic proposal which enables the transaction to move forward. It should not  
14 be segregated from the rest of the package.

15 **Q. IS THERE ALSO A TECHNICAL TAX REASON TO REJECT MR.**  
16 **KOLLEN'S PROPOSAL?**

17 A. Yes, there is. This relates to the tax normalization rules.

18 **Q. WHAT IS THE NORMALIZATION ISSUE WITH MR. KOLLEN'S**  
19 **PROPOSAL?**

20 A. The IRS has issued a number of private letter rulings in the past couple of

1 years (at least eight)<sup>3</sup> in which they have addressed the required treatment under  
2 the normalization rules of NOLC-related DTAs. They have articulated two  
3 principles which they have consistently applied. The first is that, to the extent an  
4 NOLC-related DTA is attributable to accelerated tax depreciation, the DTA must  
5 be included in the computation of rate base. The second principle is that, for this  
6 purpose, the NOL generated in any year is attributable to accelerated tax  
7 depreciation to the extent of the lesser of the accelerated tax depreciation claimed  
8 in that year or the amount of the NOL (*i.e.*, accelerated tax depreciation deductions  
9 are considered the last dollars deducted). In other words, notwithstanding our  
10 association of the NOLC with the NND abandonment deduction in order to  
11 achieve proper ratemaking, the tax normalization rules will mechanically attribute  
12 it to accelerated tax depreciation.

13 **Q. WHAT ARE THE IMPLICATIONS OF THESE PRINCIPLES FOR MR.**  
14 **KOLLEN'S PROPOSAL?**

15 A. The application of these two principles to SCE&G's 2017 NOLC requires  
16 that the amount of NOLC-related DTA included in rate base be at least equal to  
17 the amount of the DTL attributable to SCE&G's 2017 accelerated tax depreciation  
18 deduction – that is, assuming the NOL exceeds the amount of such deduction  
19 (which it does).

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<sup>3</sup> See for example PLR's 201418024, 201436037, 201436038, 201438003, 201438017, 201519021, 201534001, 201709008.

1 **Q. DOES MR. KOLLEN'S PROPOSAL CREATE A PROBLEM IN THIS**  
2 **REGARD?**

3 A. Yes, it does. His proposed \$67.1 million DTA amount does not cover the  
4 DTL created by SCE&G's 2017 accelerated tax depreciation deduction.

5 **Q. DOES THE CUSTOMER BENEFITS PLAN SUFFER FROM THIS**  
6 **PROBLEM?**

7 A. No, it does not. It includes in rate base a sufficient amount of the NOLC-  
8 related DTA to "cover" SCE&G's 2017 accelerated tax depreciation deduction.

9 **Q. MR. KOLLEN ALSO DISCUSSES THE IMPLICATIONS OF THE \$1.3**  
10 **BILLION IN CUSTOMER REFUNDS CREATING OR ADDING TO THE**  
11 **NOLC. DO YOU AGREE WITH THESE COMMENTS?**

12 A. Mr. Kollen incorrectly asserts that the Joint Applicants ignored the one-  
13 time rate credit of \$1.3 billion. The NOLC-related DTA that Dominion Energy  
14 presented in the Capital Cost Rider, and in the various models and responses  
15 provided, will not include the effects of the \$1.3 billion one-time rate credit. For  
16 tax purposes, the \$1.3 billion one-time rate credit is expected, although not  
17 assured, to generate a tax deduction at SCE&G at some point in the future as part  
18 of the Dominion Energy consolidated group. It did not in any way impact  
19 SCE&G's 2017 tax return and, thus its 2017 NND-related NOLC. Under the  
20 Customer Benefits Plan, the payment is funded by shareholders to return amounts  
21 previously collected on the NND project. To the extent the \$1.3 billion rate credit  
22 generates or adds to SCE&G's NOLC, that portion of the NOLC-related DTA will

1 be borne solely by shareholders and will not increase the NOLC DTA included in  
2 the Capital Cost Rider.

3 **Q. ASSUMING THE \$1.3 BILLION IS DEDUCTIBLE, ARE THERE ANY**  
4 **NORMALIZATION CONCERNS WITH EXCLUDING ANY CHANGE IN**  
5 **THE NOLC ASSOCIATED WITH THIS DEDUCTION?**

6 A. No, provided that the full NOLC from 2017 is included in the Capital Cost  
7 Rider as it includes in rate base a sufficient amount of the NOLC-related DTA to  
8 “cover” SCE&G’s 2017 and projected 2019 accelerated tax depreciation  
9 deductions, and a reduction associated with 2018’s projected taxable income, in  
10 conformity with the normalization rules.

11 **EXCESS DEFERRED INCOME TAXES**

12 **Q. WHAT ARE EXCESS DEFERRED INCOME TAXES (“EDIT”)?**

13 A. In years between 1988 and 2017, when SCE&G claimed (and was able to  
14 use) certain tax deductions in excess of its corresponding book expenses – most  
15 particularly accelerated (including bonus) tax depreciation - it deferred its income  
16 tax liability by an amount equal to the excess of the tax deduction over the  
17 corresponding book expense multiplied by the corporate tax rate (34 or 35%,  
18 depending on the year). The cash benefit of the income tax deferral was retained  
19 by SCE&G, recorded as ADIT and reflected in ratemaking as an offset to rate  
20 base. It was anticipated that the amount of the deferral would eventually have to  
21 be paid back to the government in the form of higher income taxes when, later on  
22 in the life of the depreciable assets, book depreciation would exceed the available



1 tax depreciation deductions. However, the reduction in the income tax rate  
2 enacted as part of the Tax Cuts and Jobs Act of 2017 (“TCJA”) altered the amount  
3 of the anticipated repayment liability. When, eventually, the higher taxable  
4 income is produced, it will be taxed at 21%, not 34 or 35%. Consequently, some  
5 portion of the ADIT reserve previously recorded on the presumption that it would  
6 be taxed at 34 or 35% is rendered unnecessary for that purpose. This portion is  
7 EDIT.

8 **Q. CAN THIS EDIT BE FLOWED THROUGH TO CUSTOMERS?**

9 A. Yes, it can be, though the timing of the flow through of some of the amount  
10 is restricted by the tax law.

11 **Q. PLEASE EXPLAIN.**

12 A. Section 13001 of the TCJA establishes a rule that is very similar to the one  
13 established in the Tax Reform Act of 1986 when the corporate income tax rate was  
14 reduced from 46% to 34%. Specifically, that section defines the term “excess tax  
15 reserve” as the excess of the ADIT reserve required by the normalization rules  
16 (that is, the ADIT reserve that is attributable to accelerated depreciation) as of the  
17 day prior to the TCJA tax rate reduction over the amount that would have been in  
18 that reserve had the new lower corporate tax rate been in effect for all prior  
19 periods. The “excess tax reserve” (which I will refer to hereafter as “protected”  
20 EDIT) can be flowed through to customers no faster than as the underlying timing  
21 differences reverse using the Average Rate Assumption Method (“ARAM”) or, if  
22 the utility doesn’t have the records necessary to apply the ARAM, ratably over the

1 remaining life of the property.

2 **Q. IS THERE ANY RESTRICTION IN THE TAX LAW ON THE TIMING OF**  
3 **FLOWING TO CUSTOMERS ANY OF THE REMAINDER OF THE EDIT**  
4 **BALANCE?**

5 A. No, there is not. The flow through of those amounts (which I will refer to  
6 hereafter as “unprotected” EDIT) can occur at whatever rate the regulator deems  
7 reasonable and appropriate.

8 **Q. HOW DOES SCE&G PROPOSE TO TREAT ITS EDIT BALANCE IN**  
9 **RATES?**

10 A. SCE&G has segregated its EDIT into two categories – plant-related EDIT  
11 and all other EDIT. SCE&G proposes to treat all plant-related EDIT the same,  
12 whether or not it is protected. It proposes that the timing of the provision of this  
13 EDIT to customers be governed by the ARAM. With respect to all other EDIT,  
14 SCE&G proposes to amortize the benefits to customers over 5 years.

15 **Q. WHY DOES SCE&G PROPOSE TREATING EDIT THIS WAY?**

16 A. SCE&G proposes using the same amortization period (the remaining life of  
17 the plant) for all plant-related ADIT for uniformity, ease of administration and  
18 sound regulatory economics. Further, as I explain below, SCE&G’s approach  
19 better matches the benefits of EDIT flowback with the customer funding of plant  
20 assets.

1 **Q. WHAT DOES MR. KOLLEN RECOMMEND WITH RESPECT TO THE**  
2 **COMPANY'S EDIT?**

3 A. Mr. Kollen recommends that the ARAM be applied only to the "protected"  
4 EDIT and that the remainder of the SCE&G's EDIT be flowed to customers over  
5 five years.

6 **Q. AS A THRESHOLD MATTER, DOES MR. KOLLEN AGREE WITH THE**  
7 **COMPANY REGARDING THE TREATMENT OF PROTECTED EDIT?**

8 A. Yes, he does. I believe both parties agree that the provision of this portion  
9 of SCE&G's EDIT to customers must be governed by the ARAM in order to  
10 comply with the tax law.

11 **Q. DOES MR. KOLLEN'S APPROACH ACHIEVE A FAIR BALANCE**  
12 **AMONG GENERATIONS OF CUSTOMERS?**

13 A. No, it does not. His recommendation does not provide the EDIT to  
14 customers in later years who are paying for plant costs through depreciation  
15 expense.

16 **Q. PLEASE PROVIDE AN EXAMPLE THAT ILLUSTRATES THIS.**

17 A. Assume that Utility X acquires a \$1,000,000 asset in Year 1 that is  
18 depreciable over twenty-five years for regulatory purposes and, for tax purposes,  
19 is deductible in its entirety as a repair in the year of acquisition. Further assume  
20 that the income tax rate in Year 1 is 35% and that in Year 2 the tax rate is reduced  
21 to 21%. Such an asset would produce \$336,000 of ADIT in Year 1 (\$1,000,000  
22 tax depreciation less \$40,000 book depreciation multiplied by 35%). At the

beginning of Year 2, \$134,400 ( $\$336,000 \times 40\%$ ) of that ADIT would become EDIT as a result of the tax rate reduction.

**Q. HOW MUCH DEPRECIATION WOULD YEAR 1 CUSTOMERS FUND?**

A. Year 1 customers would fund \$40,000 ( $\$1,000,000/25$ ) of depreciation, the same amount that would be funded by customers in Years 2 through 25.

**Q. UNDER MR. KOLLEN'S RECOMMENDATION, HOW MUCH EDIT WOULD HE FLOW TO CUSTOMERS ANNUALLY IN YEARS 2 THROUGH 6?**

A. \$26,880 each year ( $\$134,400/5$ ). This would reduce rates in each of those years by approximately \$34,025 ( $\$26,880/(1-21\%)$ ). So as a result of the asset being used in Year 1, the Year 2 through Year 6 customers would end up paying about \$5,975 per year (the \$40,000 of funded depreciation less the tax benefit of \$34,025) for the use of the asset.

**Q. WHAT IS THE EFFECT OF MR. KOLLEN'S APPROACH?**

A. Mr. Kollen would deny any EDIT benefit of the tax rate reduction to nineteen years' worth of customers – all of whom pay the exact same amount in depreciation (\$40,000) with respect to the exact same asset as was paid by customers in Year 1 through Year 6, but will receive no benefit of the EDIT.

**Q. DOES THIS ACHIEVE INTERGENERATIONAL EQUITY?**

A. No, it does not. I believe that intergenerational equity is better achieved by allocating the EDIT to all of the customers that will pay for and support the depreciable asset over its twenty-five-year life. This is true of plant that produced

1       protected EDIT and equally true of plant that produced unprotected EDIT. It is for  
2       this reason that the Customer Benefits Plan's approach to apply the ARAM to all  
3       plant-related ADIT is a more equitable and reasonable approach.

4       **Q.    IS THERE AN INDIRECT RATE IMPACT OF AMORTIZING EDIT?**

5       A.       Yes, there is. EDIT, like the ADIT it was before the income tax rate  
6       reduction, represents cost-free capital. It therefore was, and continues to be,  
7       treated as a reduction to rate base. Customers continue to benefit from the  
8       presence of unamortized EDIT through this rate base reduction. Conversely, the  
9       amortization of EDIT will reduce SCE&G's stock of cost-free capital. This  
10      necessarily results in an increase in rate base. It is not that EDIT should not be  
11      amortized. However, until it is, customers continue to derive an indirect, but  
12      important, rate benefit.

13                   **AMORTIZATION OF NOLC-RELATED DTA**

14      **Q.    WHAT DOES MR. KOLLEN PROPOSE REGARDING THE**  
15      **AMORTIZATION OF THE NOLC-RELATED DTA THAT IS**  
16      **ATTRIBUTABLE TO NND COSTS?**

17      A.       He proposes that the DTA be amortized over ten years.

18      **Q.    IS THAT A REASONABLE RECOMMENDATION?**

19      A.       No, it is not.

20      **Q.    WHY IS IT NOT REASONABLE?**

21      A.       A DTA is very different from a regulatory asset. A regulatory asset is  
22      generally a period cost that the utility has incurred which its regulators will allow

1 it to recover at some future time or over some period of time. The amortization of  
2 the regulatory asset corresponds to the recovery of the cost as designated by the  
3 regulator. In other words, the regulator controls to recovery of the cost.

4 **Q. IS THE SAME TRUE OF AN NOLC-RELATED DTA?**

5 A. No, it is not. An NOLC-related DTA is not an incurred but unrecovered  
6 cost. It is a future tax benefit that will be realized when, in a future tax year, the  
7 NOLC is used to offset taxable income. The regulator has absolutely no control  
8 over the realization of the benefit. It is purely a function of the company's tax  
9 results.

10 **Q. WHAT, THEN, IS THE ESSENTIAL DIFFERENCE BETWEEN A**  
11 **REGULATORY ASSET AND A DTA?**

12 A. A regulatory asset represents a relationship between the utility and its  
13 customers. As such, its realization is controlled by the regulator. By contrast, a  
14 DTA represents a relationship between the utility and the taxing authorities. The  
15 regulator has no control over its realization.

16 **Q. WHAT DOES THIS SIGNIFY FOR MR. KOLLEN'S**  
17 **RECOMMENDATION?**

18 A. The recommendation that the NOLC-related DTA be amortized over ten  
19 years – or any period of time – is arbitrary and without economic logic. The DTA  
20 will reverse when the Company's tax posture allows it to – no sooner and no later.  
21 Thus, his suggestion should be rejected.

**CONCLUSION**

1

2   **Q.    DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

3   **A.    Yes, it does.**